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S&P Pension Brief: Credit Effects Of Municipal Pension Plans Approaching Asset Depletion

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Some public pension plans around the country have raised concerns about whether they might completely run out of money set aside to fund pension benefits. The reasons for such a scenario vary from poor funding discipline, to investments not meeting target rates of return, to newly negotiated benefits, to demographic changes in membership. Having to fully address obligations on a pay-a--you-go (paygo) basis can add volatility and cost to budgets, just as the credit cycle may be turning. Increasingly, these poorly funded plans are addressing the possibility and repercussions of asset depletion.

This Pension Brief addresses S&P Global Ratings' views on the following questions:

- What could asset depletion mean for pension plans?
- How might asset depletion affect issuer credit ratings?
- How likely is asset depletion and what can be done to avoid it?

Sponsor governments have not typically considered plan contributions tantamount to debt and so, in times of budgetary stress, there has been leniency for pension contributions that provide short-term budgetary relief. The actual benefit payments, on the other hand, must be paid out to the members to avoid reneging on plan obligations, so contributions under paygo funding must be paid each year. Typical plan design puts the responsibility and risk on plan sponsors (the employer and any external contributors such as the state) to fund benefits in excess of a fixed employee contribution.

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